

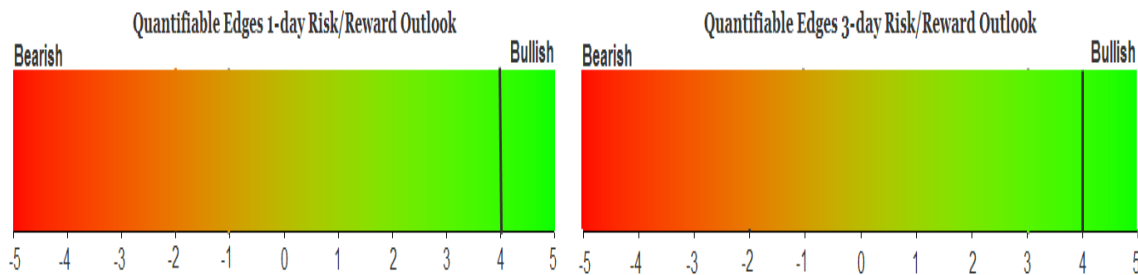
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 26, 2012

Volume 5 Issue 208

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Long	Flat

## Tonight's Research Points

- 2 outside days have been followed by short-term rallies historically.
- The reversal from a 20-day low is indicative of further short-term upside.
- The higher volume on today's bounce appears to be a negative.

## *Short-term Outlook*

### *The Bottom Line*

Same as last night. Our studies are still dominated by bullish evidence. The market remains strongly oversold. The odds suggest a bounce is near, and I continue to look to take advantage of it.

**Summary of Recent Active Studies (see Letters from listed dates for details)**

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
October 25, 2012	20-low reversal	1-6 days	Bullish	
October 25, 2012	2x outside days	1-5 days	Bullish	
October 25, 2012	High vol from RSI(2)<5	1-3 days	Bearish	
October 25, 2012	Fed Day reversal down	1-3 days	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-6 days	Bullish	
October 24, 2012	4 lower lows. 20-day low.	1-8 days	Bullish	
October 22, 2012	QE Buying Power Swing long	1-7 days	Bullish	3.10%
October 22, 2012	Oversized drop on Friday	1-6 days	Bullish	2.75%
<b>Active - Long Term</b>				
October 25, 2012	20-low > 200ma on a Fed Day	1-9 days	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-20 days	Bullish	
October 19, 2012	SPY key reversal	1-12 days	Bullish	
October 15, 2012	Breadth not diverging at top	int term	Bullish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

**The Evidence**

The market was all over the place Thursday. In the end we saw mild gains. The SPX, rose 0.3%, the Nasdaq was up 0.2% and the Russell 2000 rallied 0.4%. Breadth was moderately positive as the NYSE Up Issues % was 60% and the Up Volume % came in at 57%. Total NYSE volume rose from Wednesday's level.

Today's action brought about some interesting (and mixed) studies in the Quantifinder. I'll discuss the most compelling ones.

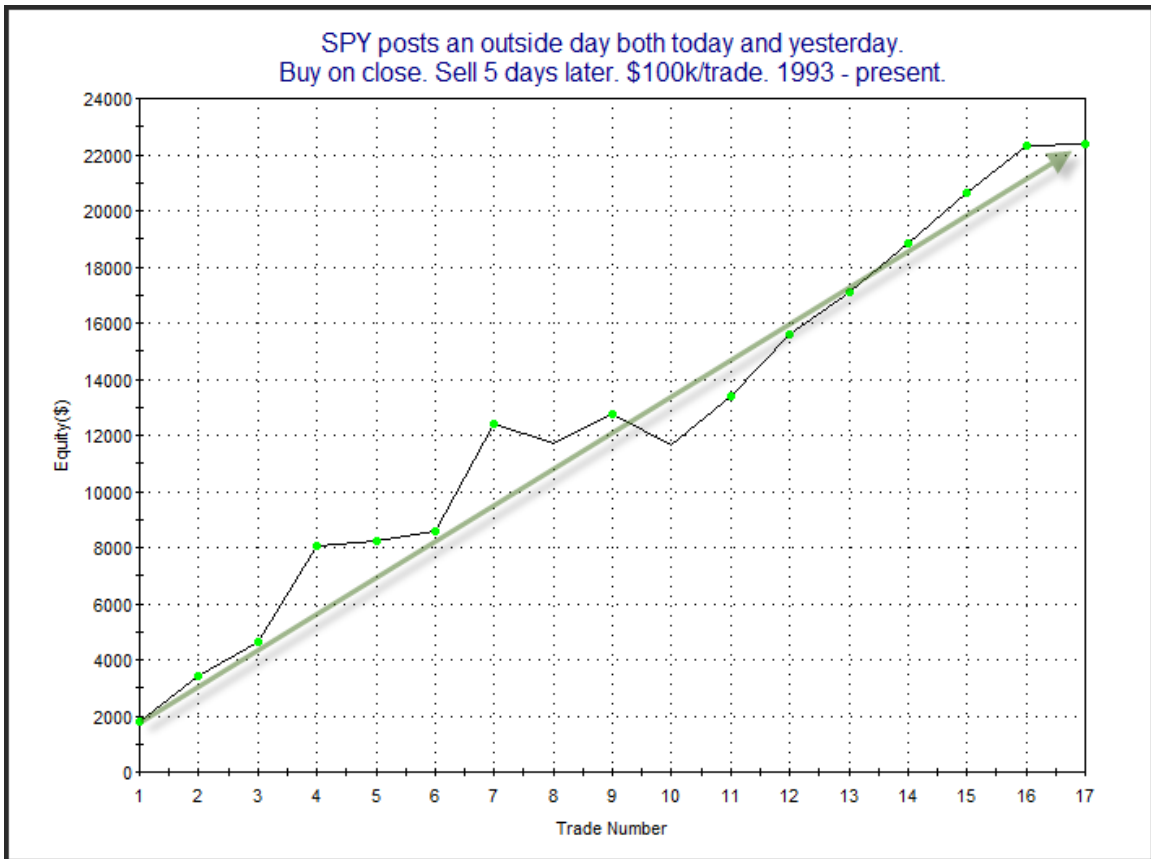
Thursday marked the 2<sup>nd</sup> day in a row that SPY posted an outside day. (An outside day is a day where the security or index makes a higher high and a lower low than the day before.) I last discussed back-to-back outside days in the 12/7/09 letter. I have not updated the SPY results since then simply because there haven't been any occurrences in the nearly 3-year period. That tells you how rare it can be. So after a long pause – here are updated results.

SPY posts an outside day both today and yesterday.  
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: /Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	22,383.42	17	15	2	88.24	1,610.00	3,826.52	-883.32	-1,080.30	1.82	13.67	1,316.67
4	18,540.36	17	15	2	88.24	1,361.27	2,617.44	-939.33	-1,545.66	1.45	10.87	1,090.61
3	16,309.69	17	12	5	70.59	1,614.81	3,447.12	-613.61	-1,404.39	2.63	6.32	959.39
2	7,966.87	17	11	6	64.71	1,107.05	1,779.33	-701.78	-1,902.99	1.58	2.89	468.64
1	5,312.79	17	11	6	64.71	764.11	1,585.08	-515.39	-1,221.57	1.48	2.72	312.52

**The only instance not to post a lower close at some point in the next week triggered on 1/3/05. It also made a long-term intraday high on that day.**

The numbers look very impressive. Below is a profit curve using a 5-day holding period.



The strong steady upslope serves as confirmation of the bullish edge. It may not seem intuitive as to why back-to-back outside days suggest a bullish edge. They imply increased volatility, and possibly overdone emotions on the part of traders. Often such conditions will be resolved with a move higher, as is demonstrated by the study.

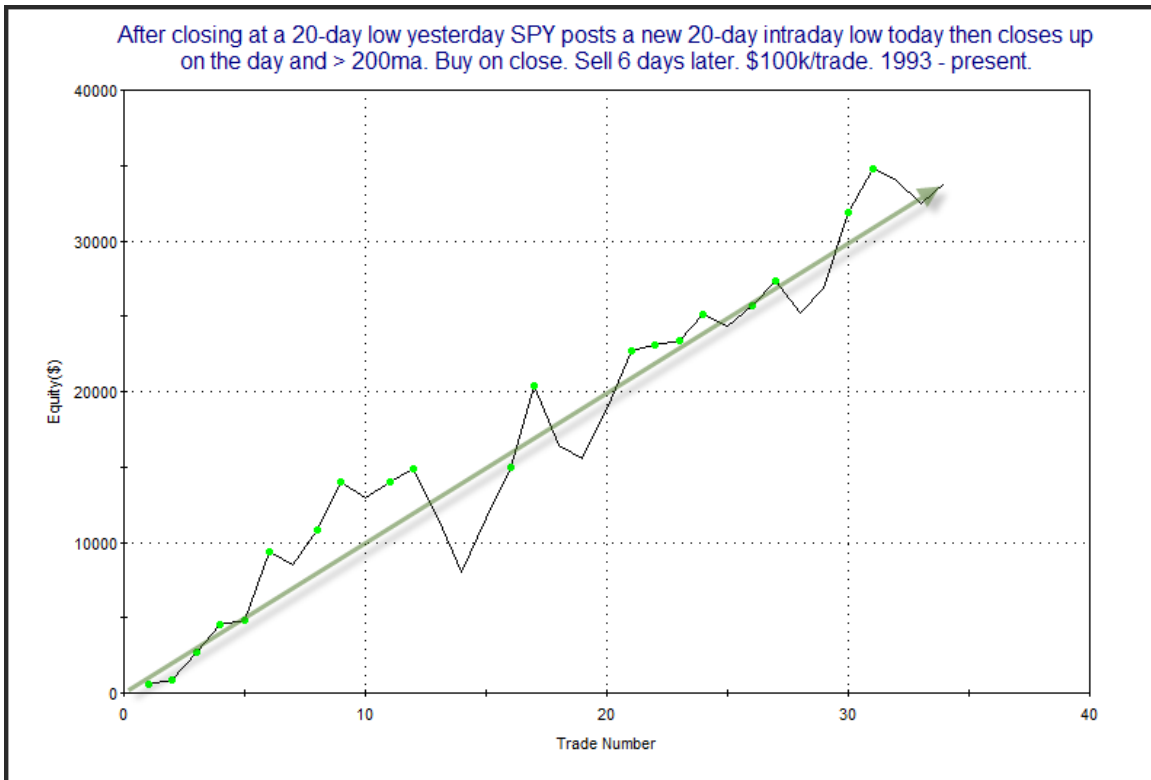
The next study to consider is the one below from the 5/26/11 letter. It looks at a possible reversal pattern off a 20-day low. All stats are updated.

After closing at a 20-day low yesterday SPY posts a new 20-day intraday low today then closes up on the day and > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: /Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	41,946.67	31	24	7	77.42	2,191.09	6,600.62	-1,519.94	-3,844.83	1.44	4.94	1,353.12
9	35,669.64	32	22	10	68.75	2,438.36	5,154.99	-1,797.44	-4,258.20	1.36	2.98	1,114.68
8	27,678.46	33	22	11	66.67	2,353.77	5,216.64	-2,191.32	-4,268.86	1.07	2.15	838.74
7	35,002.19	34	23	11	67.65	2,350.28	5,585.14	-1,732.21	-3,531.11	1.36	2.84	1,029.48
6	33,847.05	34	24	10	70.59	2,195.98	5,411.67	-1,885.66	-3,952.19	1.16	2.79	995.50
5	31,213.92	34	24	9	70.59	1,858.24	5,029.50	-1,487.09	-3,450.35	1.25	3.33	918.06
4	24,659.20	34	22	12	64.71	1,684.57	3,213.00	-1,033.45	-2,284.36	1.63	2.99	725.27
3	12,245.20	37	21	16	56.76	1,352.46	4,462.50	-1,009.77	-3,560.24	1.34	1.76	330.95
2	14,512.87	39	25	14	64.10	1,289.99	4,105.50	-1,266.92	-2,471.52	1.02	1.82	372.12
1	4,940.54	39	22	17	56.41	869.28	1,844.00	-834.33	-1,792.48	1.04	1.35	126.68

**89% of instances posted a closed above the entry price at some point in the next week.**

Results here also seem to suggest a worthwhile upside edge. Below is a profit curve using a 6-day exit strategy.



This curve also appears fairly steady, providing greater confidence in the results.

The last study to examine tonight was seen just a couple of weeks ago in the 10/12/12 letter. It noted that the higher volume on Thursday may be a bearish sign. I have copied the commentary below (but updated the results).

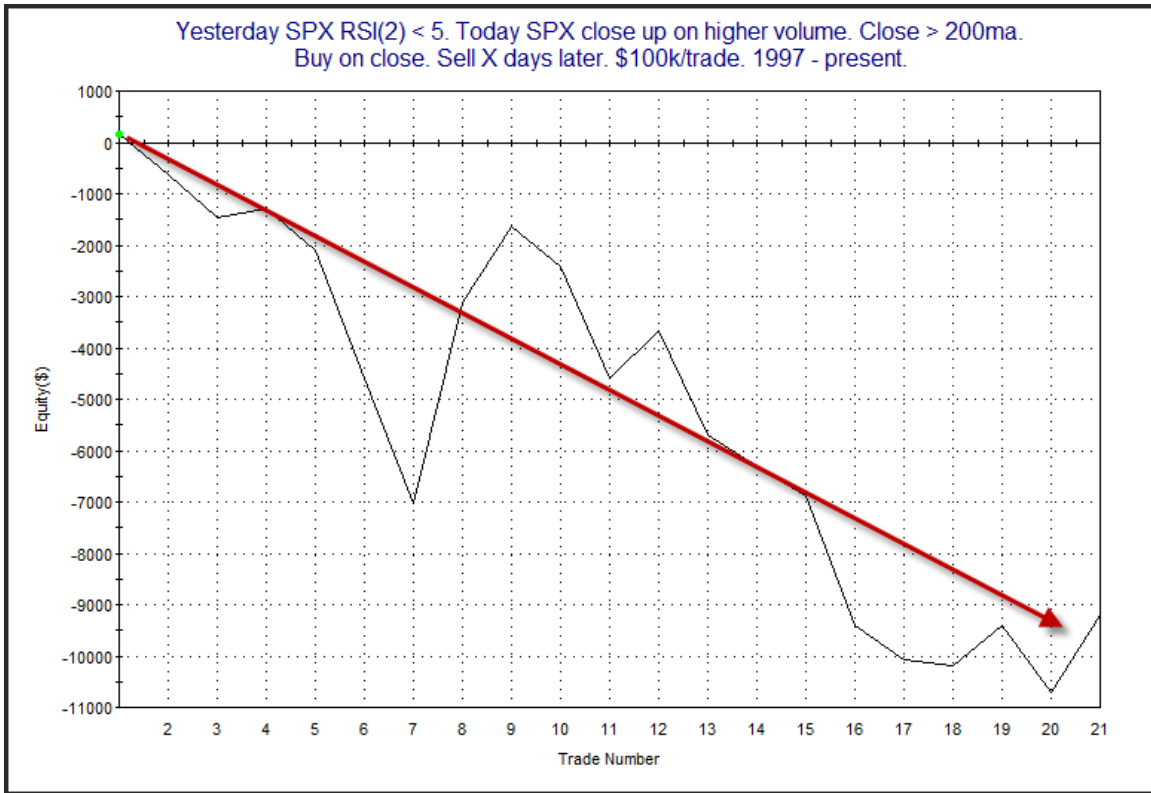
*In the 5/11/12 Letter I looked at bounces after SPX is strongly short-term oversold as measured by RSI(2). What I found in that letter was that lower-volume bounces have performed much better over the next few days than higher-volume bounces. I won't rehash the whole study tonight, but if you want to see it you may use the link below.*

[2012-05-11 QE Subscriber Letter.pdf](#)

*I do want to review the higher volume bounces in particular tonight. Below is the stats table from that letter.*

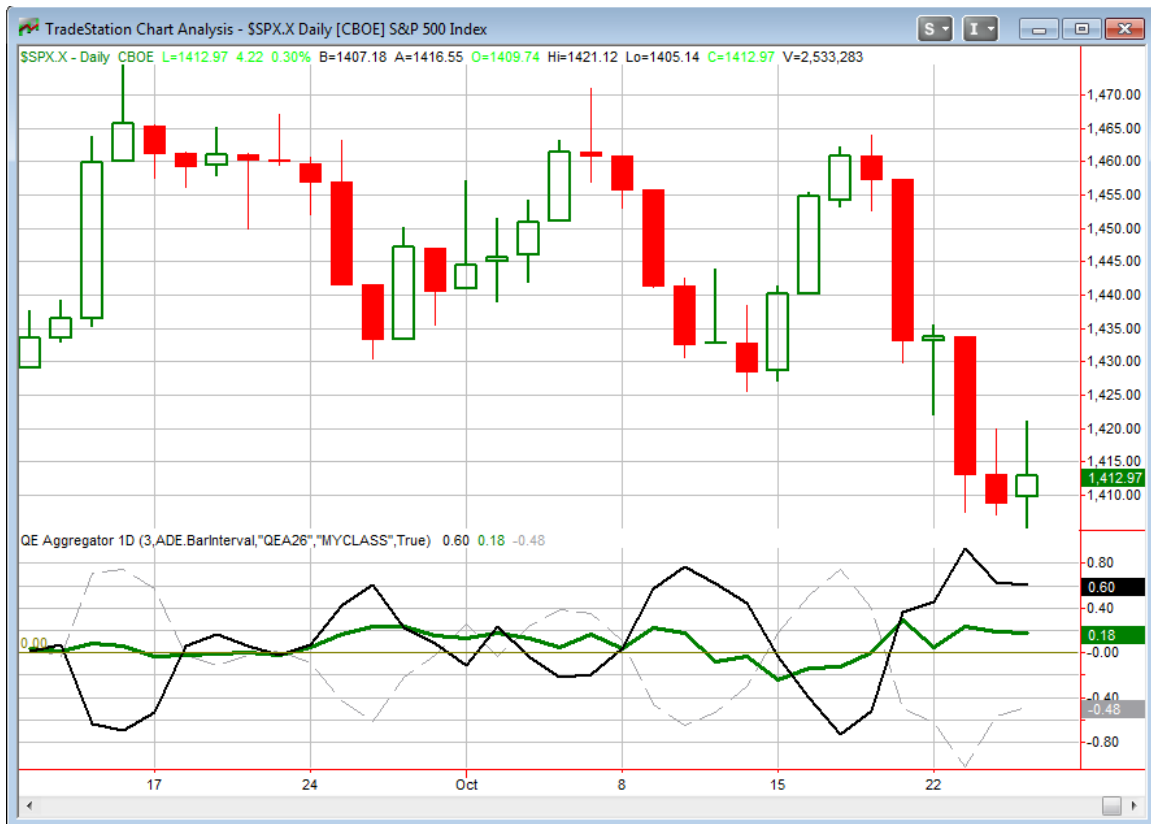
Yesterday SPX RSI(2) < 5. Today SPX close up on higher volume. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-380.57	20	10	10	50.00	1,377.09	3,532.25	-1,415.14	-2,969.64	0.97	0.97	-19.03
4	-2,260.74	21	12	9	57.14	1,013.56	2,587.95	-1,602.61	-2,541.13	0.63	0.84	-107.65
3	-9,198.93	21	7	14	33.33	1,275.75	3,939.79	-1,294.94	-2,517.13	0.99	0.49	-438.04
2	-6,406.79	22	10	12	45.45	758.16	2,794.56	-1,165.70	-1,962.36	0.65	0.54	-291.22
1	-5,863.31	22	9	13	40.91	422.09	1,020.51	-743.24	-1,774.60	0.57	0.39	-266.51

*As you can see, it appears that such bounces suggest a short-term downside edge. Tonight I also produced an equity curve using a 3-day holding period.*



*The curve is certainly choppy, but it has spent most of the time moving south and the study seems worthy of consideration.*

I have updated the [Aggregator](#) chart below.



The green Aggregator line remains well above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is also still strongly positive. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator system to remain long the close.

Based on the current studies, expectations are set to remain bullish again on Friday. Of course this could change should strong bearish evidence emerge. The Differential Pivot will be 1,421.34 on Friday. This is 0.6% above Thursday's close. So the SPX would need to close up at least this much in order to move the Differential Line into negative territory, signifying that SPX has moved from oversold to overbought.

Evidence continues to suggest the market should bounce near here. Of course according to the evidence we should have already seen such a bounce. I don't like getting too heavily involved when the market is acting against historical norms – which it appears to be doing at the moment. But there is still an awful lot pointing to a bounce. The short-term active list has 7 unrelated bullish studies and just 1 bearish study. Apple earnings disappointed after the close and the market dipped quite a bit after hours. We could get a

sizable gap down in the morning. Similar to last night, I will look to enter long on either 1) a big gap down, or 2) a sizable negative close.

I should also note that the CBI dropped to 0 today as CVS met its intraday exit target (and will be sold at tomorrow's open). The 0 CBI is a bit disconcerting during a selloff. It's unlikely I will take a 4<sup>th</sup> and final lot of SPY unless we see a sizable spike in the CBI.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 10/22– bullish***

The intermediate-term outlook was last updated in the 10/22 letter. Link below:

[2012-10-22 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*None*

***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 0***

**Additional New Trade Ideas**

*A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.*

***SPY – buy ¼ index position @ \$140.50 LIMIT ON OPEN. If not filled, cancel order and enter later as \$140.50 LIMIT ON CLOSE.*** Based on short-term outlook above. If the market gaps down large from such an oversold condition, I will consider it a gift, and enter another lot long. Otherwise, I will wait until the close to possibly add exposure.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
CVS(1/3)	10/15/2012	\$47.06	\$46.11	-2.02%		sell on open
CVS(1/3)	10/16/2012	\$47.07	\$46.11	-2.04%		sell on open
CVS(1/3)	10/17/2012	\$46.90	\$46.11	-1.68%		sell on open
SPY(1/4)	10/22/2012	\$143.15	\$141.43	-1.20%		Aggregator
SPY(1/4)	10/23/2012	\$141.42	\$141.43	0.01%		Aggregator

*CVS reached its target and will be sold at the open.*

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